

Realty Trust Review

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PORTFOLIO ADVISORY: ARE ALL THE GAINS BEHIND FOR TRUSTS WITH STRONG PROSPECTS?

That's the vital question for investors as some REIT shares have turned in extremely strong performances in the year-end stock market that many had expected would be burdened by tax-loss selling. Instead, the market for prime and middle quality REITs has turned even stronger than we'd expected just two weeks ago. At that time market strength was concentrated in the larger, widely recognized REITs, many then breaking through to new 1976 high prices. See the Nov. 26 issue for a complete list.

Now that strength has spread: C.I. Realty Investors, PNB Mortgage & Realty, Hubbard Real Estate Investments, and General Growth Properties all have moved to new yearly highs in the last week. On the ASE, Pennsylvania REIT, San Francisco RE, Security Mortgage Inv. and United Realty also hit yearly highs. Flatley Realty has moved up over 50% to 3¼ bid for the units since our Nov. 26 review; Fraser Mortgage, also reviewed that issue, is up to 9½ from 8½ bid OTC. Flatley reported 4¢ earnings in the September quarter and says it desires to return to dividend paying status in the future.

Some of these shares have backed off from their highs in the last few days, a normal trading reaction. The question is whether shares of these and other trusts with well-defined recovery prospects can move higher. We think the answer is a firm yes. Most of these recovery trusts are showing good progress in reducing problem investments earning little or no income now. Improvements drop to the bottom line almost 100%. Moreover, today's lower interest rates are widening

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GROUP RATES ON REQUEST

spreads for those trusts using the short-term money markets, boosting profits. We do not see short-term rates moving sharply higher for some time.

Thus it's possible to project gradual but steady earnings and dividend improvement for those trusts whose major problems lie behind them. We still think it will take many quarters for these trusts ever to return to peak earnings performance, if indeed they ever do. For instance, Wells Fargo Mortgage earned 11¢/sh. in its latest quarter and paid 12¢, less than one-fourth peak earnings and dividends of 56¢ and 54¢ respectively. It's possible WFM will never regain those heights but if it can earn 9% on remaining book value of \$17.24/sh., dividends and earnings would be about 38¢-39¢/sh. quarterly. At that dividend level they most certainly would sell well above current quotes about 9.

But recovery from these depressed earning levels is essentially a short-term recovery. Longer-term investment merits of these recovering REITs have to be considered and here it's necessary to make some conclusions about the investment strategies REITs should pursue in the future if they are to win support from investors. Three of our conclusions in this area are worth passing along at this time:

--Short-term financing should largely disappear. Short-term debt is a snare and a delusion to a REIT, especially a short-term construction mortgage lending trust, for a simple reason: All net income which a borrower typically would use to repay debt must be paid to shareholders as dividends before debt is repaid. This means a REIT has only three sources of funds to repay short-term debt: New equity or convertible offerings; mortgage financing on properties, using proceeds to repay debt; and liquidation of assets. The only other possibility is rollover or refinancing of existing short-term debt. Rollover could be satisfactory to a strong, low problem, institutionally sponsored long-term mortgage trust but can put a weaker, problem-ridden trust at the mercy of lenders. Thus while trusts with large amounts of short-term debt may recover in the short run, they will be unsatisfactory investments over the longer run.

--Leverage ratios must be lower. The real estate recession should mean that the days of highly leveraged mortgage trusts are over; mortgage trusts with debt-equity ratios below 2-1 have survived this recession in best fashion, and we think that sets an upper limit for prudent investor support of mortgage trusts.

--Short-term mortgage lending should largely disappear. Construction and development lending is best done by commercial banks and savings and loan associations, because of their lower cost of capital and their ability to confine such loans to a relatively small part of a much larger portfolio. Construction lending on a specialized or regional basis may be the only appropriate activity for a mortgage trust. Thus we are disappointed to see trusts like PNB Mortgage and Wells Fargo Mtg. both jump back into the same old short-term mortgage game when they can make new commitments. Such strategies are useful only to maintain earnings while problem situations are worked out; they are no substitute for a viable long-term investment strategy.

Five trusts with strong to moderate recovery patterns are reviewed this issue.

TRUST NOTES OF INTEREST: UMET Trust says it has reached agreement in principle on a long-stalled credit agreement with its banks. One bank has acquired interest of a recalcitrant bank, which had been blocking negotiations.

Cousins Mortgage & Equity says about 48% of \$107 million foreclosed property is land, of which \$35 million is raw and unimproved land. The trust plans to hold the land for 2-4 years to seek to recover its investment. Cousins shareholders are also being asked to approve internal administration; employees of the adviser would be employed by the trust directly.

WELLS FARGO MORTGAGE INVESTORS (9--NYSE--WFM) FY June 30

Real estate investments: Originally a short-term construction lending portfolio, WFM in recent years has added joint venture investments and some foreclosed property which may be held for investment. Holdings of \$172.3 million are 32% construction loans, 9% land and development loans, 19% intermediate term loans, 5% junior mortgages, 7% investments in partnerships, and 25% property acquired in foreclosure. By property type, holdings are 43½% apartments, 12% developed land, 8% undeveloped land, 7½% condominiums, 6% shopping centers, 5½% single families, 7% industrial. Investments are concentrated in areas where the adviser has offices: 27% California, 23% Texas, and 16% Arizona. During FY 1976 the trust made \$72 million new commitments, including \$30 million in residential property and \$18 million shopping center construction. Another \$28 million was added in the Sept. quarter. About 92% of these commitments carried permanent loan takeouts from third-party lenders. About one-third of new commitments were provided by sponsor Wells Fargo Bank and were added to increase earning assets and thus buy time to work out of problem loans. Partnership investments include \$4.85 million equity advances and \$7.3 million loans to 13 partnerships which construct and manage commercial, industrial and residential rental property. These partnerships operated at a \$764,000 loss in FY 1976.

About 13.9% of investments (or \$23.9 million) are classed as not earning any income, and another 25.3% (or \$43.6 million) are producing partial earnings. These investments are not lost but are temporarily hurt by depressed real estate markets. Operating properties acquired in foreclosure include \$8.2 million in a 390-unit apartment in Las Vegas; \$7.0 million in 372-unit apartment in El Paso, Tex.; and 192-space mobile home park in Oakdale, Pa. These operating properties produced a 7.3% average return on investment in fiscal 1976, before costs to carry. Partially earning foreclosures include \$10 million in a 400-unit Denver apartment and racquet club, and \$4.4 million in 292 apartments in St. Petersburg, Fla. Nonearning properties are 88% land, \$11.5 million worth. All foreclosed properties generated a \$912,000 operating profit in FY 1976, after \$705,000 depreciation charge.

Loss reserve: A total \$6.7 million has been set aside for possible future investment losses, equal to 3.9% of investments and well below the 11% industry average. Still the reserve appears adequate. These amounts aren't lost but set aside by management based upon estimated costs of holding property and any loss on disposition. A total \$25,000 was written off in FY 1976.

Financing: Total debt is 1.9 times shareholders' equity, among the lowest leverage ratios for a major construction lending trust. WFM borrows under open lines totaling \$171½ million from banks; sponsor Wells Fargo Bank provides \$50 million of these lines. Wells Fargo Bank provides about \$25 million of bank loans. WFM is the only major construction trust to continue to sell commercial paper; such paper is not rated and is sold by the bank's money desk to major corporations. Current paper sales of about \$120 million are at very low rates. Mortgages of \$16 million are being placed on four foreclosed apartments.

Management: Wells Fargo Realty Advisers, wholly owned by Wells Fargo & Co., holding company for one of the West Coast's largest banks, receives a fee based upon a percentage of assets. The adviser also holds \$150 million real estate investments for its own account. The trust uses many services provided by the sponsor.

Results & outlook: WFM resumed dividends in the December 1975 quarter with a 5¢/sh. payout and has paid successively higher amounts: 8¢, 10¢ and 12¢. These have about matched earnings, although ownership of operating properties is now providing a modest (about 2¢/sh.) quarterly cash flow over earnings. Earnings improvement seems well established and should proceed in the next few quarters, although we doubt the 2¢/sh. per quarter dividend pace can be maintained. WFM was able to resume dividends largely because the decision to resume new commitments permitted infusion of earning investments. This resumption was evidence of management's ability to contain problems and of the sponsor's willingness to provide aid in the form of some short-term originations, sale of commercial paper, and provision of a significant portion

of bank loans. Portfolio focus has shifted from all construction lending to a mix of joint venture investments and property inadvertently acquired in foreclosure, essentially making this a hybrid trust. Investment underwriting and control has been conservative enough to bring the trust through the worst of the real estate recession. The moderate 6% dividend yield on the latest 12¢ quarterly indicates the market is anticipating significant recovery toward the \$17.25/sh. book value. Lower interest cost on commercial paper has widened spreads; new mortgages on foreclosed property at 9 3/4% may use some of these benefits, however. Recent return to construction lending, which caused major troubles, is disappointing. Shares may be held for speculative price recovery. (KDC)

PNB MORTGAGE & REALTY INVESTORS (8 1/8--NYSE--PNI) FY Sept. 30

Real estate investments: Investments peaked at \$147 million in December 1974 and have been falling since as new commitments were limited for two years until being resumed selectively in July 1976. New commitments have been in short-term mortgages. Holdings stood at \$121.7 million at latest report, when the mix was 33% permanent mortgage loans; 5% standing loans on completed properties; 33% construction, development and second mortgages; 11% properties acquired in foreclosure; and 18% real estate purchased for investment. By property type at end of the 1975 FY, investments were 37% apartments, 26% condominiums, 20% office and industrial, 8% shopping centers, 5% land, and 2% mobile home parks. Investments were 28% Pennsylvania, 15% Ohio, 9% Florida, 7% each Virginia, Delaware, and Maryland, and 6% Georgia.

The trust owns 860-unit Chestnut Hill apartments and Market Square shopping area in Philadelphia, a major equity investment acquired in October 1972. The trust's \$19.1 million investment is subject to \$14.3 million first mortgages, giving PNI a \$4.8 million net investment. The project has enjoyed high occupancy and is providing satisfactory return.

A total \$24.4 million investments, or 20%, are classed as mortgages not earning income or property acquired in foreclosure, well below the 41% nonearning percentage for intermediate and long-term mortgage trusts. This amount isn't a total loss but represents properties temporarily hurt by depressed real estate markets. Operating results of foreclosed properties aren't reported separately but are said to be improving gradually. Major nonearning investments include about \$900,000 in Atlantis condominium in Ocean City, Md., enjoying good sales; \$2.4 million loan to Marbella oceanfront condos in Boca Raton, Fla.; \$4.3 million in Catawba Club Apartments in Columbus, O.; \$1.9 million in Cannons II apartments in Lima, O.; \$1.75 million in a loan to Earth City development outside St. Louis, experiencing slow progress. The \$2.1 million in Bullock-Habersham Apartments in Atlanta and \$1.5 million in Caln Crest, Coatesville, Pa. have been converted to investments. Problem investments have been held at low levels by trust policy of originating nearly all investments directly by the sponsor and its banking and mortgage banking affiliates, generally where the trust is represented by a full-time office. While problem investments have been held down, the nonearning percentage of the total has been rising slowly in recent quarters, reflecting paybacks of earning loans.

Loss reserve: The trust has set aside \$2.65 million as a reserve for possible future investment losses. This equals 2.2% of investments, well below the 11% industry average, but justified by the low level of problem investments. This amount hasn't been spent but is set aside for estimated future holding costs, including interest, of problem properties and any loss on disposition.

Financing: Total debt is 1.8 times shareholders' equity, a very low leverage ratio at this stage of the real estate cycle. The trust is among the few still issuing commercial paper, selling through the sponsor's money desk and backed by open lines with trust banks. These lines are generally at 1/4% over the prime rate and require compensating balances, some of which are provided by the trust's sponsor. The trust has two term loans from commercial banks, each for \$15 million. One loan

converted a revolving credit into a two-year term loan, recently extended to Dec. 31, 1978, with interest at 3/4% over the prime rate of the lender, Mellon National Bank of Pittsburgh. Compensating balances of 15% (or \$2.25 million) are required, of which the sponsor is supplying \$2 million and the trust the remainder. The second \$15 million term loan bears interest at 120% of the prime rate and matures November 1980. No compensating balances are required. Continental Illinois National Bank of Chicago is the lender. Mortgage debt on owned property is self-amortizing from rentals.

Management: Colonial Advisers, Inc., the adviser, is owned by Colonial Mortgage Service Co., mortgage banking subsidiary of Philadelphia National Bank. Colonial Mortgage generates from \$300 to \$500 million mortgages yearly, about 70% being single family loans. The adviser receives a percentage of invested assets as its fee. The trust was organized in October 1970.

Results & outlook: PNB earned 10¢/sh. in the September quarter and 46¢/sh. in the fiscal year ending then. Dividends have been maintained at the 10¢ quarterly level for 8 quarters beginning December 1974, slightly above the 76¢ earnings for that period. Some uptick in the dividend is possible in the next few quarters as problem investments are worked off. Investments have been generally conservatively underwritten and the trust has maintained a low level of nonearning investments, although dollar totals of nonearning investments has shown a distressing stickiness at current levels. Problem investments appear to be stabilizing however, and the trust's stress on standard income properties, especially apartments, should help speed recovery. The weakest spot appears to be relatively high condominium holdings. Recent resumption of new commitments is encouraging because it bespeaks lender and management confidence in real estate recovery, although we are not enamored of the idea of putting money back into short-term construction loans which caused most trust problems in the first place. On balance, the shares have value for longer-term recovery toward book value and possibility that recent dividend rates will be boosted as the recovery continues. (KDC)

HANOVER SQUARE REALTY INVESTORS (3 5/8--ASE--HSQ) FY Aug. 31

Real estate investments: Investments have been declining in recent quarters as no new commitments are being made and mortgage loans are repaid, bringing holdings to the current \$45.3 million. The trust began operations March 2, 1972, rather late in the real estate boom of the early 1970s, and thus its investments peaked at \$59 million in the middle of 1974. Holdings are 75% mortgage loans, 23% property acquired in foreclosure, and 2% land purchase/leasebacks. Mortgage loans are broken down as follows: 42% short-term first mortgages on completed properties, 14½% junior mortgage loans, 10% first mortgage construction loans, 8% first mortgage land loans; 20% of mortgages are in foreclosure process. The second mortgages and land/leasebacks have greatest risk, and some seconds are residual positions after permanent mortgages were closed on construction loans. Residential property has been stressed and 60% is in residential categories (apartments, condos, etc.) while 21% is retail and shopping centers, 10% office and commercial, and 8% land. Investments are predominantly in the Northeast and Mid-Atlantic states at 31% and 27% of holdings respectively. Largest states are New York, 29%, Florida, 17½% and North Carolina, 17%. Standard income properties have been stressed, providing some liquidity, and exposure to land loans (8% of the total) and condos is relatively low. Recreational properties have largely been avoided.

A total \$26.6 million investments, or 60.2%, are classed as not earning income or foreclosed, but this percentage is deceptively high. \$7.0 million foreclosed properties are all completed and producing income so that foreclosures produced \$175,000 net income after depreciation in the August 1976 FY. Management reports three other investments totaling \$8.5 million became earning in October and November, cutting full nonearning investments to 26% of holdings. During the May 1976 quarter,

HSQ disposed of two troubled problem investments, the \$1.9 million junior mortgage on the W.T. Grant office building in New York City and a \$450,000 junior mortgage on a Largo, Fla. garden apartment. HSQ took a \$2.1 million loss on the total \$2.35 million investments, illustrating how exposed junior mortgages can be in times of distress. The trust also sold a \$1.1 million investment in a Canton, N.Y. shopping center for an \$18,000 gain. HSQ has no commitments yet to be funded, except \$2 million standby commitments issued in expectation that the borrower would find alternate financing sources. In June the trust was sued in connection with a \$2.1 million standby commitment, for which it denies any liability. By and large this portfolio appears to have come through the crisis stage, and properties appear competitive once control is obtained via foreclosure.

Loss reserve: A total \$4.18 million has been set aside as a reserve for possible future investment losses, equal to 9.4% of investments, vs. the 11% industry average. This amount hasn't been spent yet but is set aside based on management's estimates of the costs of holding problem properties, including interest, and any possible losses on disposition. Disposition ahead of schedule could let the trust recover some of that reserve. HSQ has not been forced into swapping assets with its banks. The trust charged \$2.4 million to the reserve in the August 1976 FY, reflecting losses on two buildings described above.

Financing: Total debt is 2.8 times shareholders' equity, relatively low for a short-term construction lending trust and reflecting low initial leverage. The trust borrows under a two-year revolving credit signed with five banks on Oct. 3, 1975, providing: 1) Interest at 124% of the prime rate, or $\frac{1}{2}\%$ over the 90-day commercial paper rate, for three banks, with no compensating balances; and 110% of these rates for the other two banks, with 10% compensating balances; 2) total credit availability of \$33.7 million, subject to continuing compliance with net worth and cash flow requirements; availability declines if capital (net worth plus subordinated debentures) falls below \$19 million (current availability is \$28 million); 3) Dividends to a maximum \$50,000 quarterly, if earned and necessary to maintain REIT status. On balance this credit agreement is favorable to shareholders because it does not involve contingent interest or the other trappings of deep distress.

Management: Pearce, Mayer & Greer, Inc., New York City mortgage banking and brokerage firm, wholly owned by W.R. Grace Co., advises the trust. The adviser currently is to receive its actual expenses as its fee but deferred \$462,000 in the 1976 FY under agreement with its banks.

Results & outlook: Earnings deficits have persisted for six quarters now and HSQ reported a loss of \$1.18 per share in the August 1976 FY without making any fresh additions to the loss reserves. Management believes that the portfolio outlook is such that new additions to the reserve are not needed. The trust appears to have come through the worst of the real estate recession with management and financing intact. Properties by and large have proved to be competitive for current conditions. The high level of second mortgages is disturbing but we feel the loss reserve adjusts already for this risk. Realistically we do not see dividends for another year or so but neither do we view this trust as a liquidation candidate. Recovery should proceed slowly and recent restoration of three properties to earning status is encouraging. The shares are an excellent speculative candidate for partial recovery toward book value. Debentures should be retained and can be purchased for speculative $11\frac{1}{2}\%$ yield. Portfolio liquidity appears adequate to support continued interest payments. (KDC)

VIRGINIA REAL ESTATE INVESTMENT TRUST (6 $\frac{1}{2}$ --OTC--VARES) FY Dec. 31

Real estate investments: The depreciated portfolio was down to \$42 million on Sept. 30, 9% below a year earlier. This trust has been relatively successful in reducing its problems and getting paybacks. Thus investments now stand at 70% operating properties, 17% foreclosed properties and 13% earning mortgage loans.

Operating properties by gross cost are 52% shopping centers, 37% apartments, 8% motel and 2% land under apartments. Geographic concentration is in the home state of Virginia and neighboring states.

The four shopping centers, three in Virginia (Charlottesville, Norfolk and Williamsburg) and one in Jacksonville, N.C., derive the highest returns among holdings. All are strip centers with 107-480,000 sf. All are 100% occupied and are up substantially in revenues in 1976 as they have been every year since acquired in 1972. The three in Virginia are on significant overages while the newest in North Carolina is only five years on stream. Tenants are prominent nationals and strong locals: Woolco, Leggett, Miller & Rhodes, A & P, Kroger, Colonial, Eckert, Rose's, Winn Dixie, Penney, etc. All the centers have a little land for modest expansion.

Four apartment projects are in Blacksburg and Charlottesville, Va., Salisbury, Md., and Greenville, N.C. These are low rise, garden and town house type, relatively new (around six years old). They are all almost 100% full and bring about an 8-9% return. They are said to be in strong markets with rents competitive in the \$200-250/month range for a typical two-bedroom apartment. All properties, shopping centers and apartments, are said to be well maintained with an eye toward future value.

Remaining mortgage loans are all earning, bringing a satisfactory return on current borrowing costs. Loans are mostly on standard type real estate, all first mortgages except for two small seconds. Their paydown will provide over half the funds for repayment on borrowed funds.

Nonearning investments are comprised of foreclosures, the trust having foreclosed all its non-earning mortgages, the last this past April. Foreclosures total \$7 million, 17% of the entire portfolio. These number a condominium and six land parcels. The condo in Charlottesville, Va. was just completed. The \$863,000 project was already partly sold by the previous owner. Units are \$25-65,000, well below single family homes in this affluent community. The \$6.1 million in land parcels appears readily salable when markets return to development phases. All but one are in Virginia. A \$753,000 parcel is zoned for apartments in Chester, Va.; no development is taking place in the area but the tract will be attractive when the market starts again. A \$523,000 parcel in Richmond has older improvements carrying it. Well located but in a declining neighborhood, prospects are good for commercial use. A \$1.6 million, 50-acre tract is at the corner of a major interchange, Routes 66 and 234, in Manassas. It is the only undeveloped quadrant at the interchange and zoned with water and sewers. An \$849,000 plot in downtown Philadelphia is being carried as a parking lot; substantial interest exists. A \$1.7 million, 900 acre tract 3 miles from Williamsburg city limits fronts on Route 60 and is suitable for multiple development. But this and some of the other parcels have been around awhile and ultimate disposition can not be timed.

Loss reserve: The reserve now stands at \$1.8 million, 14% of the mortgage and foreclosed portfolio. The trust wrote down \$1 million in 1975. No further loss provisions were made in 1976. It appears that problems are well accounted for giving confidence in stated remaining book value.

Financing: Debt is 2.3 times equity. The 30% of debt not secured by mortgages on owned property is borrowed under bank lines. Interest is 3% over the prime rate and the effective rate was reduced under amendment Nov. 19, 1976 by giving the trust credit for cash balances. Main features of the amendment extended repayments scheduled: \$475,000 on Dec. 31, 1977; \$1 million each on Dec. 31 of 1978, 1979 and 1980. Maturity on Dec. 31, 1981 calls for a balloon of \$4.4 million. Any foreclosure proceeds are applied.

Sponsor: Trust is independent and self administered. Permission was granted for REIT disqualification but the trust intends to qualify.

Results & outlook: The last four quarters were profitable, Sept. getting up to 11¢/sh. Additionally, net cash flow amounted to 22¢/sh., indicating nearly a 9% annual return on shareholders' equity after carrying 17% of investments at nearly no return. Further improvement is likely as apparently a base has been established.

However, the degree will depend on when foreclosed land is sold freeing up funds more productively. While the trust intends to pay dividends of 90% of earnings, 1976 earnings are tax sheltered from a loss carryforward. Thus no formal dividend policy is established. But obviously there is dividend paying capability of 40¢ annually available right now. The shares are still attractive at 35% below \$10 book value as this represents depreciated properties providing satisfactory return. (BS)

FRANKLIN REALTY & MORTGAGE TRUST (2 3/4--ASE-FR) FY June 30

Real estate investments: Holdings were reduced 5% in the year ended June 30 to \$44.5 million. In August, the short-term mortgage portfolio of \$7.8 million was swapped to banks bringing investments now down to \$36.7 million. The trust is now effectively all equity. The mortgage loans retained are comprised mostly of \$4.9 million juniors on jointly owned property. The bulk of properties have been long held, carried for depreciated value of \$28.5 million. These consist 71% in office buildings, 25% apartments and 4% motels. The biggest office buildings are \$3.6 million Medical Towers, Houston and \$4.1 million Jefferson Bank, New Orleans. Smaller office buildings are in Baltimore, Coral Gables, Tulsa, Chicago, Cleveland, Cincinnati and Santa Ana. Half the apartment value is Marlow Overlook in Washington, D.C. with the others in Baltimore, Philadelphia and San Antonio. There is also \$1.9 million invested equity in three joint ventures: Franklin-Diboll which leases an 18-story motel in New Orleans, La.; Franklin International Plaza in which the trust is general partner owning a 230,000 sf office building in Coral Gables, Fla. erected at a cost of \$12 million; and Rydal Executive Plaza in which the trust is general partner owning a 31,000 sf office building in Rydal, Pa. which cost \$1.3 million. Additionally, the trust has investments of \$4.9 million in these two office buildings in form of second mortgage loans.

The trust, now nonqualified for tax purposes, recently undertook several financial/real estate service activities. These encompass property management for outsiders in addition to the trust, investment advice for institutions and investment syndication. Property management is getting off the ground. With basic overhead being covered by in-house requirements, work for outsiders should be lucrative. Syndication is also active. The first three are to be sold out by the end of 1976 and another eight are expected in 1977. Both these activities are expected to provide revenues of a few hundred thousand dollars.

The trust's largest single investment is Franklin International Plaza, the Coral Gables office building. Completed in 1974 after cost overruns, the building was slow leasing up. Thus Franklin's \$4.4 million second mortgage is drawing only half its 15% face interest and its share of the fiscal 1976 loss was \$203,000. The building is now 96% leased but rentals will not take full effect until March-June 1977. Free rent concessions had to be given up front to sign some leases. Since leases are full rate, the building should be profitable next fiscal year. The only remaining hurdle is granting of reasonable tax assessment. Tenancy is high quality. IBM took the first 40%. Others include five major life insurance companies, ITT, Dow Corning, E.F. Hutton, Gardner Denver and Dow-Jones.

The basic portfolio was marginal the past two years. Operating loss was \$778,000 in fiscal 1976 before \$90,000 contribution from joint ventures (stemming from the New Orleans motel). Essentially, expenses outstripped revenues as escalators lagged. Office building leases are now 70% escalated and of course all new leases are now so written. Occupancies were also a little lower in some buildings earlier in fiscal 1976. The two clearly troublesome office buildings are in Tulsa, Okla., 39,000 sf 55% occupied and in Cincinnati, O., 47,000 sf 60% occupied. Both are cash flow negative. These buildings have \$2.2 million book value. Rents are being raised aggressively which is thought will bring the portfolio's return up.

Loss reserve: Only \$31,000 is allowed for losses and \$174,000 for doubtful accounts.

Financing: With a 5.1 leverage ratio, funds of \$47 million on June 30 were provided: 33% short-term bank notes, 39% secured mortgages, 11% convertible debentures and 17% equity. The \$15.5 million bank debt was since reduced to \$6.5 million by mortgage loan swap. This is at 1/4% over the prime rate with a term loan in negotiation.

Results & outlook: Operating losses continued in the Sept. quarter with a \$203,000 deficit reported after \$100,000 writeoff for mortgage loan portfolio assembly. Improvement is likely as higher rentals become effective. Shares may be held for recovery. (BS)